AGM season 2020: Critical demand preprogrammed

Topic of the month March 2020

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The 2020 Annual General Meeting season will delight shareholders with dividend payments of around 37 billion euros in the DAX 30 alone. But is it really a reason to be happy? Dividend payments are always a product of the past, but on the stock exchange the future is being traded. This must be questioned at the shareholder meetings. After all, good corporate governance and sustainable business practices are the key to long-term economic success and should therefore be actively demanded by investors.

The focus of the upcoming annual general meetings will be on how companies can ensure the sustainability of their business model in the context of the changed economic environment. The challenges are numerous: a more fragile economic activity and increased geopolitical risks on the one hand. Rising demand for equities due to the ECB's low interest rate policy on the other, which drive valuations. Large conglomerates or inefficiently managed companies are breathing down the neck of activists, forcing corporate leaders to split and split up, pay higher dividends or make strategic shifts.

The annual general meetings will therefore be the place to critically question the situation. We expect increasingly active institutional shareholders who are committed to more transparency with regards to their investment strategies, their participation policy and its implementation through regulatory requirements. Among investors in Germany, this shareholder commitment, in addition to returns, is also playing an increasingly important role, as a representative YouGov survey commissioned by Deka showed 71 percent of the securities owners surveyed consider it important for investment companies to actively promote the issue of corporate governance at annual general meetings. More than half of those surveyed (56 percent) are convinced that this commitment will increase the share price of the company concerned in the long term. Additionally, for 41 percent of investors, this is even a buying factor when they decide to invest in the equity fund of a particular fund company.

The remuneration of the board of directors is one of the perennial topics at annual general meetings. In this year's annual general meeting season, the topic is gaining further importance due to the implementation of the second shareholders' rights directive (ARUG II). Some companies are already trying to comply with the changes required by ARUG II and the revised Corporate Governance Code. However, at least a flood of new compensation programs is expected in 2021. The current discussion focuses primarily on the absolute amount. If the maximum total compensation for the members of the Executive Board - both for the Executive Board as a whole and for each individual member of the Executive Board - set in the compensation system is inappropriately high, shareholders should react.

More important than the total amount, however, is the salary structure - and thus the weighting of the individual remuneration components. As a general rule, the remuneration structure for members of the Board of Management must be geared towards sustainable, long-term corporate development and must not tempt them to take unreasonable risks. It should be transparent and comprehensible and contribute to promoting the business strategy and the long-term development of the company. The remuneration system for the management board must be voted on at least every four years at the annual general meeting on every significant change to the system.

When structuring the remuneration of the management board, companies should ensure that the remuneration system consists of three basic elements, namely fixed remuneration, annual and multi-year variable remuneration. For each individual member of the management board, the target and maximum total remuneration and the respective components for the forthcoming financial year should be added. The relevant financial and non-financial performance criteria for granting the variable components of remuneration should be specified. Of particular interest to shareholders is the link between target achievement and variable remuneration. Increasingly, they are also questioning the payment modalities, i.e. how the members of the management board can dispose of the variable remuneration amounts. For better comparability, the average compensation of managers and staff should also be disclosed - ideally in a historical comparison.

Holding periods or the obligation to invest in own shares play an increasingly important role in the remuneration system. Management board members should hold shares in their company, ideally in the amount of at least one gross annual fixed salary. This personal investment should be reached after four years at the latest. A further point of discussion is the pension scheme. The era of all-round carefree packages is over. Companies should make commitments to company pension schemes exclusively on a defined contribution basis and link them to fixed remuneration. Similarly, pension contributions can be paid out directly to the member of the management board, thus enabling him or her to invest at their own accountability.

When selecting and determining the target figures for remuneration, it is crucial that they reflect the desired corporate strategy as accurately as possible. In addition, in the interests of incentive and control, their development should be transparent and comprehensible and offer little room for manipulation and external influences.

Over the past decade, shareholders and board members have benefited from rising share prices. As a result, there are an increasing number of voices that want to link the total variable compensation to the share price. The Total Shareholder Return (TSR) is often cited for this purpose. At first glance, this linkage may seem sensible, but it can lead to misplaced incentives. In a longer-term stock market downturn, for example, there is little incentive to improve one's own performance because it has no influence on the share price. Conversely, if the share price is driven by exogenous factors, the reward is independent of the actual performance of the management. TSR should therefore only play a role in combination with other criteria. In addition, different performance criteria should be used for one-year and multi-year variable remuneration. In general, the variable remuneration components should relate to demanding performance targets and evaluation parameters which may not be changed retroactively to facilitate the achievement of objectives. Even if the case law is not clear, variable remuneration components should also provide for a remuneration reclaim, so-called claw backs, in the event of grossly negligent and immoral conduct. Sustainability aspects should also be anchored as a target figure in long-term remuneration in particular. These non-financial performance indicators focus on environmental (e.g. carbon dioxide emissions) or social aspects.

Despite these complex demands on the remuneration systems for executive boards in companies, one thing must not be forgotten: An optimal remuneration program combines consideration of the many different factors with good readability and a high degree of comprehensibility. For Deka in 2020, in addition to the issues of board of management remuneration systems, the independence and competence of the supervisory board will also be of great importance. As in the previous season, the issue of sustainability will be at the center of our attention. We place particular emphasis on environmental issues and compliance with human rights. In general, sustainability and AGM voting are increasingly converging and the financial sector will see a flood of new sus-

tainability regulations, which will also increase the pressure on listed companies. We have therefore included our positions on these issues in our AGM voting policy.

With regard to the composition of the supervisory board, we believe it is important that the majority of its members are independent and that their competence profile corresponds to the company's business model. When it comes to the topic of the accumulation of offices, we need to take a closer look again. With regard to diversity, we see a need to catch up, especially with MDAX and SDAX companies. It will also be exciting to see to what extent companies will comply with the new German Corporate Governance Code in advance and thus improve the quality of good corporate governance.

We plan to further expand our commitment to corporate governance. In this context, we are also expanding our team, further developing our already intensive AGM reporting and increasing the number of AGMs at which we participate and vote. The aim is to fulfil our fiduciary duties in the interests of long-term value enhancement of the assets entrusted to us.

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About DEKA

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